

CITY OF FROSTBURG, MARYLAND
FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2006

***HM* Huber, Michaels
& Company**

Certified Public Accountants

CITY OF FROSTBURG, MARYLAND

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INDEPENDENT AUDITORS' REPORT

Mayor and City Council
City of Frostburg, Maryland
Frostburg, Maryland

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the remaining fund information of City of Frostburg, Maryland, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City of Frostburg, Maryland's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the remaining fund information of the City of Frostburg, Maryland, as of June 30, 2006, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 3, 2006, on our consideration of the City of Frostburg, Maryland's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and the budgetary comparison information on pages 3 – 14 and 39, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Frostburg, Maryland's basic financial statements. The accompanying information listed in the table of contents as supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Huber, Michael & Company

Cumberland, Maryland
November 3, 2006

CITY OF FROSTBURG, MARYLAND
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
JUNE 30, 2006

City of Frostburg Management's Discussion and Analysis

As management of the City of Frostburg, we offer readers of the City of Frostburg's financial statements this narrative overview and analysis of the financial activities of the City of Frostburg for the fiscal year ended June 30, 2006. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the city's financial statements, which follow this narrative.

Financial Highlights

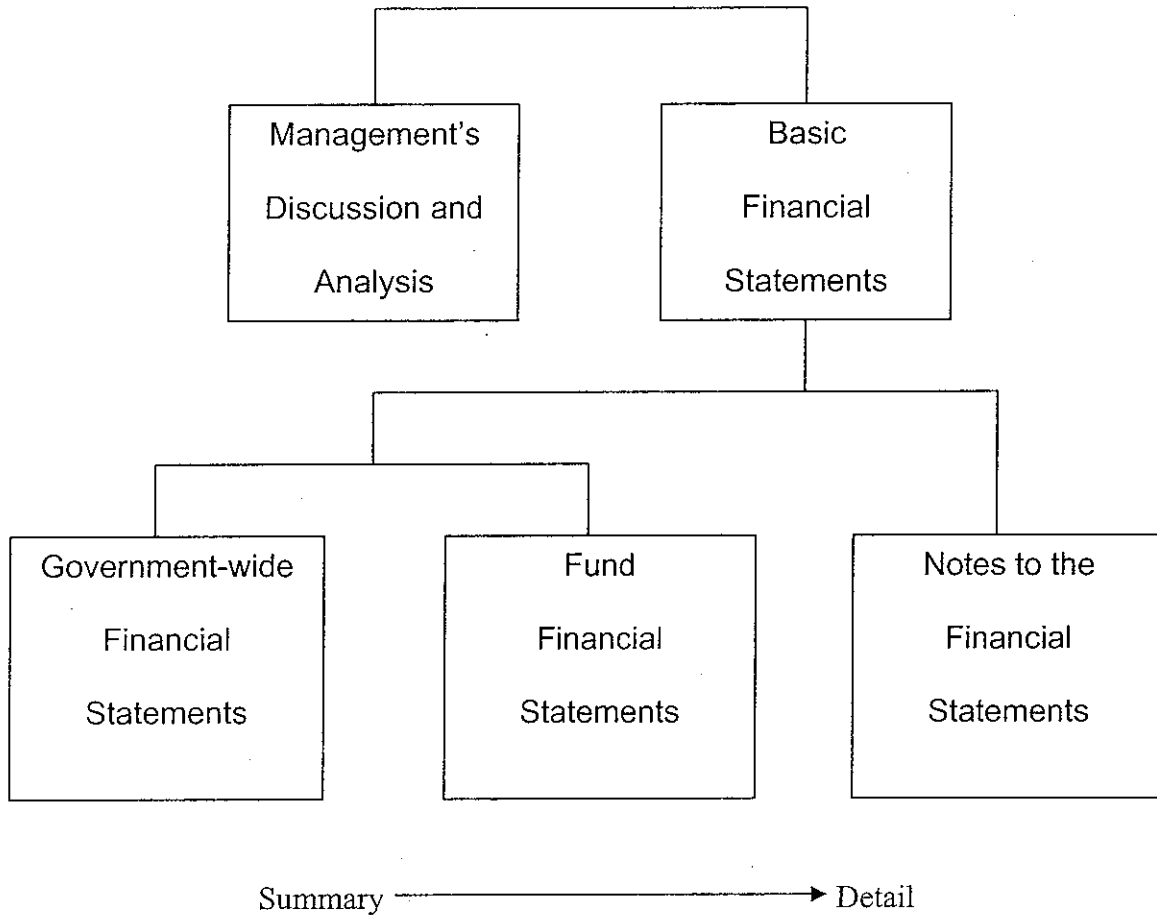
- The assets of the City of Frostburg exceeded its liabilities at the close of the fiscal year by \$21,973,447.
- The government's total net assets increased by \$1,500,805, primarily due to increases in the business-type activities net assets.
- As of the close of the current fiscal year, the City of Frostburg's governmental funds reported combined ending fund balances of \$1,568,847 an increase of \$134,668 in comparison with the prior year. Approximately 100 percent of this total amount, or \$1,568,847, is available for spending at the government's discretion.
- At the end of the current fiscal year, unreserved fund balance for the General Fund was \$1,496,402, or 43 percent of total general fund expenditures for the fiscal year.
- The City of Frostburg's total debt decreased by \$478,915, or 4 percent during the current fiscal year. This decrease is primarily the result of debt repayment.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to City of Frostburg's basic financial statements. The city's basic financial statements consist of three components; 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements (see Figure 1). The basic financial statements present two different views of the city through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental information that will enhance the reader's understanding of the financial condition of the City of Frostburg.

Required Components of Annual Financial Report

Figure 1



Basic Financial Statements

The first two statements (pages 15 & 16) in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the City of Frostburg financial status.

The next statements (pages 17 - 23) are **Fund Financial Statements**. These statements focus on the activities of the individual parts of the city government. These statements provide more detail than the government-wide statements. There are three parts to the Fund Financial Statements: 1) the governmental funds statements; 2) the budgetary comparison statements; and 3) the proprietary fund statements.

The next section of the basic financial statements is the notes (pages 26 – 38). The notes to the financial statements explain in detail some of the data contained in those

Management Discussion and Analysis

City of Frostburg

statements. After the notes, supplemental information is provided to show details about the city's individual funds. Budgetary information required by the General Statutes also can be found in this part of the statements.

Government-wide Financial Statements

The government-wide financial statements are designed to provide the reader with a broad overview of the city finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the city financial status as a whole.

The two government-wide statements report the city's net assets and how they have changed. Net assets are the difference between the city's total assets and total liabilities. Measuring net assets is one way to gauge the city's financial condition.

The government-wide statements are divided into two categories: governmental activities and business-type activities. The governmental activities include most of the city's basic services such as public safety, streets, parks and recreation, and general administration. Taxes and state and federal grant funds finance most of these activities. The business-type activities are those that the city charges customers to provide. These include the water, sewer and refuse services offered by the City of Frostburg.

The government-wide financial statements are on pages 15 and 16 of this report.

Fund Financial Statements

The fund financial statements provide a more detailed look at the city's most significant activities. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Frostburg, like all other governmental entities in Maryland, uses fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the city's budget ordinance. All of the funds of City of Frostburg can be divided into two categories: governmental funds and proprietary funds.

Governmental Funds – Governmental funds are used to account for those functions reported as governmental activities in the government-wide financial statements. Most of the city's basic services are accounted for in governmental funds. These funds focus on how assets can readily be converted into cash flow in and out, and what monies are left at year-end that will be available for spending in the next year. Governmental funds are reported using an accounting method called modified accrual accounting that provides a short-term spending focus. As a result, the governmental fund financial statements give the reader a detailed short-term view that helps him or her determine if there are more or less financial resources available to finance the city's programs. The relationship between governmental activities (reported in the Statement of Net Assets and the

Management Discussion and Analysis City of Frostburg

Statement of Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements.

The City of Frostburg adopts an annual budget for its General Fund, as required by the charter. The budget is a legally adopted document that incorporates input from the citizens of the city, the management of the city, and the decisions of the Mayor & Council about which services to provide and how to pay for them. It also authorizes the city to obtain funds from identified sources to finance these current period activities. The budgetary statement provided for the General Fund demonstrates how well the city complied with the budget ordinance and whether or not the city succeeded in providing the services as planned when the budget was adopted. The budgetary comparison statement uses the budgetary basis of accounting and is presented using the same format, language, and classifications as the legal budget document. The statement shows four columns: 1) the original budget as adopted by the Mayor & Council; 2) the final budget as amended by the Mayor & Council; 3) the actual resources, charges to appropriations, and ending balances in the General Fund; and 4) the difference or variance between the final budget and the actual resources and charges. To account for the difference between the budgetary basis of accounting and the modified accrual basis, a reconciliation showing the differences in the reported activities is shown at the end of the budgetary statement.

Proprietary Funds – City of Frostburg has two different kinds of proprietary funds. Enterprise Funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City of Frostburg uses enterprise funds to account for its water, water surcharge, sewer and refuse activity. These funds are the same as those functions shown in the business-type activities in the Statement of Net Assets and the Statement of Activities.

Special Revenue Funds are an accounting device used to accumulate and allocate costs internally among the functions of the City of Frostburg. The city uses a special revenue fund to account for one activity – its Community Development Block Grant activity. Because this activity benefits predominantly governmental rather than business-type activities, the special revenue fund has been included within the governmental activities in the government-wide financial statements.

Notes to the Financial Statements – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements are on pages 26 - 38 of this report.

Government-Wide Financial Analysis

The government-wide financial statements include the Statement of Net Assets. The Statement of Net Assets presents information on all of the City of Frostburg's assets and

Management Discussion and Analysis
City of Frostburg

liabilities, with the difference between the two reported as Net Assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating. The Statement of Activities is also included in the government-wide financial statements. The focus of the Statement of Activities is to show how the government's assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). The government-wide statements include the Statement of Net Assets and the Statement of Activities and can be found on pages 15 - 16 of this report.

The City of Frostburg's Net Assets

Figure 2

	Governmental Activities		Business-Type Activities		Total	
	2006	2005	2006	2005	2006	2005
Current and other assets	\$ 1,760,535	\$ 1,716,544	\$ 988,536	\$ 1,710,702	\$ 2,749,071	\$ 3,427,246
Non-current assets	81,748	104,243	148,021	159,942	229,769	264,185
Capital assets	8,969,209	8,701,161	21,596,155	19,941,658	30,565,364	28,642,819
Total assets	10,811,492	10,521,948	22,732,712	21,812,302	33,544,204	32,070,065
Long-term liabilities outstanding	320,577	432,269	9,768,317	10,149,594	10,088,894	10,581,863
Other liabilities	224,479	260,919	1,257,384	1,018,826	1,481,863	1,279,745
Total liabilities	545,056	693,188	11,025,701	11,168,420	11,570,757	11,861,608
Net assets:						
Invested in capital assets, net of related debt	8,611,281	8,240,679	11,491,951	9,489,783	20,103,232	17,730,462
Restricted	200,464	296,343	256,463	1,588,850	456,927	1,885,193
Unrestricted	1,454,691	1,291,738	(41,403)	(434,751)	1,413,288	856,987
Total net assets	\$ 10,266,436	\$ 9,828,760	\$ 11,707,011	\$ 10,643,882	\$ 21,973,447	\$ 20,472,642

As noted earlier, net assets may serve over time as one useful indicator of a government's financial condition. The assets of the City of Frostburg exceeded liabilities by \$21,973,447 as of June 30, 2006. The city's net assets increased by \$1,500,805 for the fiscal year ended June 30, 2006. However, the largest portion (91%) reflects the city's investment in capital assets (e.g. land, buildings, machinery, and equipment); less any related debt still outstanding that was issued to acquire those items. The City of Frostburg uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City of Frostburg's investment in its capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since the capital assets cannot be used to liquidate these liabilities. An additional portion of the City of Frostburg's net assets

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City of Frostburg

(2%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of \$1,413,288 is unrestricted.

Several particular aspects of the City financial operations positively influenced the total unrestricted governmental net assets:

- Continued diligence in the collection of property taxes by maintaining a tax collection percentage of 95.4%.
- Increase in real estate tax assessments.
- Increase in highway user tax from the State of Maryland.
- Continued diligence by City employees to utilize resources to work within the means of the City.

Management Discussion and Analysis
City of Frostburg

City of Frostburg Changes in Net Assets
Figure 3

	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues:						
Charges for services	\$ 255,403	\$ 507,763	\$ 3,242,599	\$ 2,629,162	\$ 3,498,002	\$ 3,136,925
Operating grants and contributions	170,689	169,846	-	-	170,689	169,846
Capital grants and contributions	243,447	223,159	1,012,104	584,896	1,255,551	808,055
General revenues:						
Property taxes	1,408,404	1,339,461	-	-	1,408,404	1,339,461
Other taxes	1,156,127	852,039	-	-	1,156,127	852,039
Grants and contributions not restricted to specific programs	-	-	-	-	-	-
Other	156,311	188,095	373,011	28,376	529,322	216,471
Total revenues	3,390,381	3,280,363	4,627,714	3,242,434	8,018,095	6,522,797
Expenses:						
General government	664,379	500,838	-	-	664,379	500,838
Public safety	1,135,138	1,072,750	-	-	1,135,138	1,072,750
Public works	808,414	1,062,379	-	-	808,414	1,062,379
Recreation and parks	369,118	304,678	-	-	369,118	304,678
Community development	48,308	68,094	-	-	48,308	68,094
Code enforcement	98,644	81,493	-	-	98,644	81,493
Interest on long-term debt	17,612	22,082	-	-	17,612	22,082
Water, sewer and garbage	-	-	3,375,677	3,054,790	3,375,677	3,054,790
Total expenses	3,141,613	3,112,314	3,375,677	3,054,790	6,517,290	6,167,104
Increase in net assets before transfers	248,768	168,049	1,252,037	187,644	1,500,805	355,693
Transfers	281,440	184,000	(281,440)	(184,000)	-	-
Increase in net assets	530,208	352,049	970,597	3,644	1,500,805	355,693
Net assets, July 1	9,828,760	9,334,834	10,643,882	10,640,238	20,472,642	19,975,072
Prior Period Adjustment	-	141,877	-	-	-	141,877
Net assets, July 1 as restated	9,828,760	9,476,711	10,643,882	10,640,238	20,472,642	20,116,949
Transfer of Fund Balance	(92,532)	-	92,532	-	-	-
Net assets, June 30	\$ 10,266,436	\$ 9,828,760	\$ 11,707,011	\$ 10,643,882	\$ 21,973,447	\$ 20,472,642

Governmental activities. Note the Statement of Activities is significantly different than a typical Statement of Revenues, Expenses and Changes in Fund Balance. Expenses are listed in the first column with revenues for that particular program reported to the right. The result is a Net Revenue/(Expense). The reason for this format is to highlight the relative financial burden of each of the functions on the City's taxpayers. It also identifies how much each function draws from the general revenues or if it is self-financing through fees and grants.

Governmental activities increased the city's net assets by \$530,208, thereby accounting for 35% of the total growth in the net assets of the City of Frostburg. Key elements of this increase are as follows:

- The renovation of the Frostburg Community Swimming Pool.
- The purchase of a dump truck for the Street Department.
- The re-instatement of the street paving program.

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Business-type activities: Business-type activities increased the City of Frostburg's net assets by \$970,597, accounting for 65% of the total growth in the government's net assets. Key elements of this increase are as follows:

- The increase in the water surcharge fee.
- The increase in capital assets with the completion of the Water Street combined sewer overflow project and the Water Treatment Plant reservoir dome cover and security upgrade project.
- The establishment of the Refuse Fund.

Financial Analysis of the City Funds

As noted earlier, the City of Frostburg uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds. The focus of the City of Frostburg's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing the City of Frostburg's financing requirements. Specifically, unreserved fund balance can be a useful measure of a government's net resources available for spending at the end of the fiscal year.

The general fund is the chief operating fund of the City of Frostburg. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$1,496,402, while total fund balance reached \$1,568,847. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 43 percent of total General Fund expenditures.

At June 30, 2006, the governmental funds of the City of Frostburg reported a combined fund balance of \$1,568,847, a 9 percent increase over last year. Included in this change in fund balance is an increase in fund balance in the General Fund and a decrease in fund balance in the Special Revenue Fund.

General Fund Budgetary Highlights: During the fiscal year, the Mayor & City Council publicly amended the budget. Generally, budget amendments fall into one of three categories: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal and State grants; and 3) increases in appropriations that become necessary to maintain services.

- General Fund revenues were on budget target except for real estate tax revenue and highway use tax revenue which were greater than originally estimated. General fund expenditures were on budget target except for legal expenses which were greater than originally estimated.

Management Discussion and Analysis
City of Frostburg

- The City was able to comply with its budgetary requirements.

Proprietary Funds. The City's proprietary funds provide the same type of information found in the government-wide statements but in more detail. Unrestricted net assets of the Water, Water Surcharge, Sewer and Garbage Funds at the end of the fiscal year amounted to \$(41,403). The total increase in net assets was \$970,597. Other factors concerning the finances of these two funds have already been addressed in the discussion of the City's business-type activities.

Capital Asset and Debt Administration

Capital assets. The City of Frostburg's investment in capital assets for its governmental and business-type activities as of June 30, 2006, totals \$30,565,364 (net of accumulated depreciation). These assets include buildings, roads, land, machinery and equipment, park facilities, and vehicles.

Major capital asset transactions during the year include the following additions and demolitions:

- Completion of combined sewer overflow project on Water Street of \$1,413,156.
- Purchase of a dump truck for the Water Department of \$72,392.
- Construction project for City Place of \$23,629.
- Renovation project of Lyric (Paul's Hall) Building of \$239,552.
- Purchase of a dump truck for the Street Department of \$103,936.
- Completion of renovation of the Frostburg Swimming Pool of \$372,890.
- Completion of the Water Treatment Plant Reservoir Dome Cover and Security Upgrades of \$1,700,589.
- The 2005-2006 street paving project of \$115,418.

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City of Frostburg's Capital Assets

Figure 4

(net of depreciation)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Land and construction in progress	\$ 1,948,699	\$ 2,218,210	\$ 95,547	\$ 805,949	\$ 2,044,246	\$ 3,024,159
Buildings and systems	1,983,173	1,823,257	5,740,100	6,016,035	7,723,273	7,839,292
Improvements other than buildings	724,959	390,148	8,138,902	8,469,265	8,863,861	8,859,413
Machinery and equipment	404,703	368,434	485,975	439,732	890,678	808,166
Infrastructure	3,907,675	3,901,112	7,135,631	4,210,677	11,043,306	8,111,789
Total	\$ 8,969,209	\$ 8,701,161	\$ 21,596,155	\$ 19,941,658	\$ 30,565,364	\$ 28,642,819

Additional information on the City's capital assets can be found in note 5 of the Basic Financial Statements.

Long-term Debt. As of June 30, 2006, the City of Frostburg had total bonded debt outstanding of \$10,490,867. Of this, \$357,928 is debt backed by the full faith and credit of the City. The remainder of the City's debt represents bonds secured solely by specified revenue sources.

**City of Frostburg's Outstanding Debt
General Obligation and Revenue Bonds**

Figure 5

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
General obligation bonds	\$ 357,928	\$ 460,482			\$ 357,928	\$ 460,482
Revenue bonds			10,132,939	10,509,300	\$ 10,132,939	\$ 10,509,300
Total	\$ 357,928	\$ 460,482	\$ 10,132,939	\$ 10,509,300	\$ 10,490,867	\$ 10,969,782

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The City of Frostburg's total debt decreased by \$478,915 (4%) during the past fiscal year. Debt principal payments during the past fiscal year were \$478,915.

Additional information regarding the City of Frostburg's long-term debt can be found in note 6 beginning on page 33 of this report.

Economic Factors and Next Year's Budgets and Rates

The following key economic indicators reflect the growth and prosperity of the City.

- Frostburg State University is the largest employer in the City and the surrounding area. Upon the retirement of University President, Dr. Catherine Gira in June 2006, Dr. Jonathan Gibraltar, was named as the new University President of Frostburg State University and expects to increase standards and enrollment. In addition the University has initiated a technology-based business incubator (currently with 3 tenants) in the former science building, Tawes Hall that is expected to attract new private sector employment to the campus. Future growth is also expected from new technology-based business locations in the Allegany Business Center at Frostburg State University, an on-campus business park developed jointly with Allegany County.
- ACS, the City's second largest employer, continues to expand its facilities and grow its work force. They employ over 500 people and their commercial contracts for customer service call center services continue to attract new clients.
- The City of Frostburg has an ongoing Main Street revitalization program that is having tangible results. Programs are expected to have beneficial results in the areas of façade improvements and community marketing programs.
- Allegany County continues to market and attract interest in the land and buildings in the Frostburg Business Park. It is expected that the County will successfully attract new employers to the former Kreative Plastics plant, a 30,000 square foot assembly plant and to the former Northrop Grumman building, a 20,000 square foot office facility. The Park also has lots available for both small projects and at least one larger venture.
- The continued growth in the traffic counts along Interstate 68 is expected to generate new investment in sites at the intersections of I-68 and MD Rt. 36 and at I-68 and Midlothian Road. Both interchanges have development potential that is within City limits or just outside that will add benefit to the City.
- A new Rite Aid store constructed along MD Rt. 36 is serving as the anchor for the site being developed as a commercial/professional center.

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- The Prichard Farm is the focus of development plans by a venture that includes both a metropolitan real estate developer and local firms. A major new planned residential subdivision is being planned for the site that could add 400 new housing units over the course of 10 to 12 years. The project began construction in 2006. It is the single largest venture in all of Allegany County.
- Successful business attractions and expansion at other area employers such as ATK Tactical Systems and American Woodmark will bring additional growth to Frostburg as a location for employees to live. Both of these firms are located east of Frostburg. To the west, Closet Maid is expected to begin their long awaited project in 2006.

Budget Highlights for the Fiscal Year Ending June 30, 2007

Governmental Activities: Property taxes (benefiting from the economic growth) and revenues from highway use fee are expected to lead the increase in budgeted revenue by 9.0 percent. The City will use these increases in revenues to finance the participation in the Maryland State Retirement and Pension System for City employees. Employees will receive credit under the new system retroactively dated based on when they became employed by the City. The City is purchasing 50% of the back service at a cost not to exceed \$1,629,590. This cost will be financed at a fixed rate of interest over 25 years.

Budgeted expenditures in the General Fund are expected to rise 11.0%. The largest increments are in employee compensation, including funding compensation and benefits.

No capital items have been budgeted.

Business – type Activities: The water and sewer rates will be revised after a final determination by the Maryland Public Service Commission. Water surcharge rates will be increased for all customers.

Requests for Information

This report is designed to provide an overview of the City finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to the Director of Finance, Candace R. Sandvick, P.O. Box 440, Frostburg, MD 21532, 301-689-6000 x13, csandvick@allconet.org.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF NET ASSETS
JUNE 30, 2006

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Current Assets:			
Cash and cash equivalents	\$ 666,019	\$ 624,313	\$ 1,290,332
Certificate of deposit	84,403	-	84,403
Accounts receivable	380,282	934,844	1,315,126
Prepaid expenses	54,511	4,699	59,210
Internal balances	575,320	(575,320)	-
Total Current Assets	<u>1,760,535</u>	<u>988,536</u>	<u>2,749,071</u>
Capital Assets			
Non-depreciable	1,948,699	95,547	2,044,246
Depreciable, net of accumulated depreciation	7,020,510	21,500,608	28,521,118
Total Capital Assets, net of accumulated depreciation	<u>8,969,209</u>	<u>21,596,155</u>	<u>30,565,364</u>
Non-current Assets			
Bond & loan costs, net of accumulated amortization	-	148,021	148,021
Notes receivable	81,748	-	81,748
Total Non-current Assets	<u>81,748</u>	<u>148,021</u>	<u>229,769</u>
TOTAL ASSETS	<u>\$ 10,811,492</u>	<u>\$ 22,732,712</u>	<u>\$ 33,544,204</u>
LIABILITIES			
Current Liabilities:			
Accounts payable and accrued expenses	\$ 93,272	\$ 778,467	\$ 871,739
Salaries and benefits payable	22,585	8,224	30,809
Sanitary Commission payable	-	70,000	70,000
Deposits	-	15,018	15,018
Current portion of long-term debt	108,622	385,675	494,297
Total Current Liabilities	<u>224,479</u>	<u>1,257,384</u>	<u>1,481,863</u>
Noncurrent Liabilities:			
Compensated absences	71,271	21,053	92,324
Long-term debt	249,306	9,747,264	9,996,570
Total Noncurrent Liabilities	<u>320,577</u>	<u>9,768,317</u>	<u>10,088,894</u>
TOTAL LIABILITIES	<u>545,056</u>	<u>11,025,701</u>	<u>11,570,757</u>
NET ASSETS			
Invested in capital assets, net of related debt	8,611,281	11,491,951	20,103,232
Restricted	200,464	256,463	456,927
Unrestricted	1,454,691	(41,403)	1,413,288
TOTAL NET ASSETS	<u>10,266,436</u>	<u>11,707,011</u>	<u>21,973,447</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 10,811,492</u>	<u>\$ 22,732,712</u>	<u>\$ 33,544,204</u>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2006

	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
	Function/Programs	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government
Primary Government						
Governmental Activities:						
General government		\$ 664,379	\$ 166,260	\$ 1,015	\$ -	\$ (497,104)
Public safety		1,135,138	46,097	169,674	-	(919,367)
Public works		808,414	-	-	24,576	(783,838)
Recreation and parks		369,118	41,146	-	218,871	(109,101)
Community development		48,308	-	-	-	(48,308)
Code enforcement		98,644	1,900	-	-	(96,744)
Interest on long-term debt		17,612	-	-	-	(17,612)
Total Governmental Activities		3,141,613	255,403	170,689	243,447	(2,472,074)
Business-type Activities:						
Water		1,063,094	938,297	-	-	(104,797)
Sewer		928,774	1,277,183	-	1,012,104	1,360,513
Water Surcharge		1,106,218	680,937	-	-	(425,281)
Garbage		277,591	326,182	-	-	48,591
Total Business-type Activities		3,375,677	3,242,599	-	1,012,104	879,026
Total Primary Government		\$ 6,517,290	\$ 3,498,002	\$ 170,689	\$ 1,255,551	(1,593,048)
General Revenues:						
Taxes						
Net property taxes						1,408,404
Income taxes						387,475
Highway use tax						563,547
Hotel motel tax						154,690
Admission taxes						50,415
Rental income						78,150
Licenses and permits						52,572
Interest earnings						33,305
Timber sales						339,706
Miscellaneous revenues						8,497
Transfers						(281,440)
Total General Revenues, Special Items, Extraordinary Items and Transfers						3,093,853
Change in Net Assets						1,500,805
Net Assets - July 1, 2005						20,472,642
Transfer of Fund Balance from General Fund to Garbage Fund						(92,532)
Net Assets - June 30, 2006						\$ 10,266,436
						\$ 11,707,011
						\$ 21,973,447

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

**BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2006**

	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total Governmental Funds</u>
ASSETS			
Cash and cash equivalents	\$ 560,022	\$ 105,997	\$ 666,019
Certificate of deposit	84,403	-	84,403
Accounts receivable	380,282	-	380,282
Internal receivables	575,300	20	575,320
Prepaid expenses	54,511	-	54,511
TOTAL ASSETS	<u>\$ 1,654,518</u>	<u>\$ 106,017</u>	<u>\$ 1,760,535</u>
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts payable and accrued expenses	\$ 92,994	\$ -	\$ 92,994
Salaries and benefits payable	22,585	-	22,585
Internal payables	(33,572)	33,572	-
Deferred revenues	76,109	-	76,109
TOTAL LIABILITIES	<u>158,116</u>	<u>33,572</u>	<u>191,688</u>
FUND BALANCES			
Fund balance - Unrestricted	<u>1,496,402</u>	<u>72,445</u>	<u>1,568,847</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 1,654,518</u>	<u>\$ 106,017</u>	<u>\$ 1,760,535</u>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2006

Total Fund Balances - Governmental Funds \$ 1,568,847

Amounts reported for governmental activities in the statement
of net assets are different because:

Capital assets used in governmental activities are not financial resources and
therefore are not reported in the governmental funds

Governmental capital assets, net of accumulated depreciation 8,969,209

Accounts receivable from taxes not collected within 60 days of year end
are reported as deferred revenue in the governmental funds

Deferred revenue from taxes receivable 76,109

Notes receivable do not provide current resources and are not reported
in the governmental funds

81,748

Accrued interest is recorded on fund statements only when due

(278)

Long-term liabilities are not due and payable in the current period, and
therefore are not reported as liabilities in the funds.

Long-term debt (249,306)

Current portion of long-term debt (108,622)

Compensated absences (71,271)

(429,199)

TOTAL NET ASSETS - GOVERNMENTAL ACTIVITIES

\$ 10,266,436

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2006**

	<u>General Fund</u>	<u>Special Revenue</u>	<u>Total Governmental Funds</u>
REVENUES			
Taxes			
Net property tax revenue	\$ 1,457,557	\$ -	\$ 1,457,557
Income taxes	387,475	-	387,475
Hotel motel tax	154,690	-	154,690
Highway use tax	563,547	-	563,547
Other taxes	118,742	-	118,742
Police protection grant	138,489	-	138,489
Public safety revenue	71,069	-	71,069
Licenses and permits	52,572	-	52,572
COPS grants	31,185	-	31,185
Rental program revenue	58,125	-	58,125
Recreational activities	41,146	-	41,146
Grant income - other	244,163	-	244,163
Other income	25,531	23,691	49,222
Interest	12,971	2,925	15,896
	<hr/>	<hr/>	<hr/>
TOTAL REVENUES	3,357,262	26,616	3,383,878
	<hr/>	<hr/>	<hr/>
EXPENDITURES			
Administration	808,529	-	808,529
Public safety	1,111,262	-	1,111,262
Street department	600,252	-	600,252
Recreation department	324,586	-	324,586
Debt service	102,554	-	102,554
Capital outlays	552,015	33,899	585,914
	<hr/>	<hr/>	<hr/>
TOTAL EXPENDITURES	3,499,198	33,899	3,533,097
	<hr/>	<hr/>	<hr/>
EXCESS OF EXPENDITURES OVER REVENUES	(141,936)	(7,283)	(149,219)
	<hr/>	<hr/>	<hr/>
OTHER FINANCING SOURCES (USES)			
Interfund transfers	197,000	-	197,000
Transfer from water fund from sale of timer	84,440	-	84,440
Rental income	78,150	-	78,150
	<hr/>	<hr/>	<hr/>
TOTAL OTHER FINANCING SOURCES (USES)	359,590	-	359,590
	<hr/>	<hr/>	<hr/>
NET CHANGE IN FUND BALANCES	217,654	(7,283)	210,371
	<hr/>	<hr/>	<hr/>
FUND BALANCE - JULY 1, 2005	1,354,451	79,728	1,434,179
	<hr/>	<hr/>	<hr/>
TRANSFER OF FUND BALANCE TO GARBAGE FUND	(75,703)	-	(75,703)
	<hr/>	<hr/>	<hr/>
FUND BALANCE - JUNE 30, 2006	\$ 1,496,402	\$ 72,445	\$ 1,568,847
	<hr/>	<hr/>	<hr/>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

**RECONCILIATION OF THE GOVERNMENTAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2006**

Total Net Change in Fund Balance - Governmental Funds \$ 210,371

**Amounts reported for governmental activities in the statement
of activities are different because:**

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is depreciated over their estimated useful lives.

Expenditures for capital assets	585,914	
Less current year depreciation	<u>(299,838)</u>	286,076

Repayment of note proceeds is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.		90,273
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Repayment of capital leases is an expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.		12,281
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Proceeds from notes receivable are reported as revenues in governmental funds, but they are recorded against the note receivable balance in the statement of net assets.		(22,496)
--	--	----------

Some revenues reported in the statement of activities do not provide current financial resources and, therefore, are not reported as revenues in governmental funds.		
Change in deferred revenues		(49,152)

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds.		
Change in accrued interest		146
Change in compensated absences		2,709

TOTAL CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES		<u><u>\$ 530,208</u></u>
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The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2006

	Water	Sewer	Water Surcharge	Garbage	Total
ASSETS					
Current Assets:					
Cash	\$ 122,932	\$ 172,030	\$ 291,648	\$ 37,703	\$ 624,313
Accounts receivable	171,886	513,799	146,600	102,559	934,844
Prepaid expenses	2,937	1,762	-	-	4,699
Total Current Assets	<u>297,755</u>	<u>687,591</u>	<u>438,248</u>	<u>140,262</u>	<u>1,563,856</u>
Capital Assets					
Non-depreciable	-	47,248	48,299	-	95,547
Depreciable, net of accumulated depreciation	1,508,004	3,386,643	16,587,933	18,028	21,500,608
Total Capital Assets, net of accumulated depreciation	<u>1,508,004</u>	<u>3,433,891</u>	<u>16,636,232</u>	<u>18,028</u>	<u>21,596,155</u>
Non-current Assets					
Bond & loan costs, net of accumulated amortization	-	-	148,021	-	148,021
TOTAL ASSETS	<u>\$ 1,805,759</u>	<u>\$ 4,121,482</u>	<u>\$ 17,222,501</u>	<u>\$ 158,290</u>	<u>\$ 23,308,032</u>
LIABILITIES					
Current Liabilities:					
Accounts payable and accrued expenses	\$ 59,770	\$ 524,031	\$ 179,806	\$ 14,860	\$ 778,467
Salaries and benefits payable	4,286	2,468	-	1,470	8,224
Sanitary Commission payable	-	70,000	-	-	70,000
Deposits	15,018	-	-	-	15,018
Due to other funds	421,688	140,627	-	13,005	575,320
Due to other proprietary funds	(150,000)	-	150,000	-	-
Current portion of long-term debt	-	42,275	343,400	-	385,675
Total Current Liabilities	<u>350,762</u>	<u>779,401</u>	<u>673,206</u>	<u>29,335</u>	<u>1,832,704</u>
Noncurrent Liabilities					
Compensated absences	9,533	10,688	-	832	21,053
Notes payable, less current portion	-	211,164	9,536,100	-	9,747,264
Total Noncurrent Liabilities	<u>9,533</u>	<u>221,852</u>	<u>9,536,100</u>	<u>832</u>	<u>9,768,317</u>
TOTAL LIABILITIES	<u>360,295</u>	<u>1,001,253</u>	<u>10,209,306</u>	<u>30,167</u>	<u>11,601,021</u>
Net Assets					
Invested in capital assets, net of related debt	1,508,004	3,209,187	6,756,732	18,028	11,491,951
Restricted	-	-	256,463	-	256,463
Unrestricted - undesignated	(231,420)	(88,958)	-	110,095	(210,283)
- designated	168,880	-	-	-	168,880
Total Net Assets	<u>1,445,464</u>	<u>3,120,229</u>	<u>7,013,195</u>	<u>128,123</u>	<u>11,707,011</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,805,759</u>	<u>\$ 4,121,482</u>	<u>\$ 17,222,501</u>	<u>\$ 158,290</u>	<u>\$ 23,308,032</u>

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 PROPRIETARY FUNDS
 FOR THE YEAR ENDED JUNE 30, 2006

	Water	Sewer	Water Surcharge (Restricted)	Garbage	Total
OPERATING REVENUES	\$ 958,297	\$ 1,277,183	\$ 680,937	\$ 326,182	\$ 3,242,599
OPERATING EXPENSES					
Depreciation and amortization	109,903	96,942	644,345	-	851,190
Sewer operating	-	620,358	-	-	620,358
Salaries and wages	199,226	140,417	-	67,075	406,718
Filtration contract payments	330,022	-	-	-	330,022
Employee benefits	85,276	43,364	-	37,341	165,981
Landfill charges	-	-	-	119,126	119,126
Pumping system	110,928	-	-	-	110,928
Other	48,332	9,054	9,517	14,102	81,005
Distribution	65,981	-	-	-	65,981
Meters expense	45,305	-	-	-	45,305
Transmission	36,100	-	-	-	36,100
Sanitation operating	-	-	-	35,271	35,271
Payroll taxes	14,191	10,072	-	4,676	28,939
Purification	17,830	-	-	-	17,830
Total Operating Expenses	1,063,094	920,207	653,862	277,591	2,914,754
Operating Income (Loss)	(104,797)	356,976	27,075	48,591	327,845
NON-OPERATING REVENUE (EXPENSES)					
Project reimbursements	-	1,012,104	-	-	1,012,104
Timber sales	339,706	-	-	-	339,706
Interest revenue	1,435	-	31,870	-	33,305
Interest expense	-	(8,567)	(452,356)	-	(460,923)
Total Non-operating Revenues (Expenses)	341,141	1,003,537	(420,486)	-	924,192
Income Before Transfers	236,344	1,360,513	(393,411)	48,591	1,252,037
Transfers out	(176,440)	(92,000)	-	(13,000)	(281,440)
Change in Net Assets	59,904	1,268,513	(393,411)	35,591	970,597
TOTAL NET ASSETS - JULY 1, 2005	1,385,560	1,851,716	7,406,606	-	10,643,882
TRANSFER OF FUND BALANCE FROM GENERAL FUND	-	-	-	92,532	92,532
TOTAL NET ASSETS - JUNE 30, 2006	\$ 1,445,464	\$ 3,120,229	\$ 7,013,195	\$ 128,123	\$ 11,707,011

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2006

	Water	Sewer	Water Surcharge	Garbage	Total
CASH FLOWS FROM OPERATING ACTIVITIES:					
Receipts from customers and users	\$ 975,077	\$ 1,283,047	\$ 627,707	\$ 302,632	\$ 3,188,463
Payments to vendors	(737,352)	(727,780)	(9,517)	(197,865)	(1,672,514)
Payments to employees	(196,623)	(138,091)	-	(67,069)	(401,783)
Net Cash Provided by Operating Activities	41,102	417,176	618,190	37,698	1,114,166
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:					
Transfers out	(176,440)	(92,000)	-	(13,000)	(281,440)
Change in due to/from other funds	17,970	127,637	204,759	13,005	363,371
Net Cash Provided By (Used In) Noncapital Financing Activities	(158,470)	35,637	204,759	5	81,931
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:					
Purchase of capital assets	(72,392)	(895,227)	(1,280,826)	-	(2,248,445)
Principal paid on loans	-	(41,961)	(334,400)	-	(376,361)
Proceeds from accounts receivable - CDA	-	-	953,556	-	953,556
Project reimbursements	-	920,348	-	-	920,348
Timber sales	339,706	-	-	-	339,706
Interest paid on loans	-	(10,499)	(454,000)	-	(464,499)
Net Cash Provided By (Used In) Capital and Related Financing Activities	267,314	(27,339)	(1,115,670)	-	(875,695)
CASH FLOWS FROM INVESTING ACTIVITIES					
Interest earned	1,435	-	31,870	-	33,305
Net change in Cash	151,381	425,474	(260,851)	37,703	353,707
Cash and cash equivalents (cash overdraft), beginning of year	(28,449)	(253,444)	552,499	-	270,606
Cash and cash equivalents, end of year	\$ 122,932	\$ 172,030	\$ 291,648	\$ 37,703	\$ 624,313
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES					
Operating Income (Loss)	\$ (104,797)	\$ 356,976	\$ 27,075	\$ 48,591	\$ 327,845
Adjustments Not Affecting Cash					
Depreciation	109,903	96,942	632,424	-	839,269
Amortization	-	-	11,921	-	11,921
(Increase) decrease in accounts receivable	1,762	5,864	(53,230)	(23,550)	(69,154)
(Increase) decrease in prepaid expenses	(709)	(425)	-	-	(1,134)
Increase (decrease) in accounts payable and accrued expenses	17,322	(44,507)	-	12,649	(14,536)
Increase (decrease) in salaries and benefits payable	993	296	-	375	1,664
Increase (decrease) in deposits	15,018	-	-	-	15,018
Increase (decrease) in compensated absences	1,610	2,030	-	(367)	3,273
Total Adjustments	145,899	60,200	591,115	(10,893)	786,321
Net Cash Provided By Operating Activities	\$ 41,102	\$ 417,176	\$ 618,190	\$ 37,698	\$ 1,114,166

The accompanying notes are an integral part of these financial statements.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 REPORTING ENTITY

The City of Frostburg, Maryland (the "City") was incorporated in 1870 and adopted its first Charter in 1885. The City operates under a Council-Administrator form of government per Charter Revision Resolution No. 23 adopted July 1, 1981. The City of Frostburg adopted Charter Revision Resolution No. 2001-17 on December 21, 2001, effective February 2, 2002 which repealed the 1981 edition and also provides the following services as authorized by its Charter: public safety (police and fire), public works (maintenance, sewer, streets, and water), recreation, community development and general administrative services.

In evaluating how to define the City of Frostburg, Maryland, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in generally accepted accounting principles (GAAP). The basic, but not the only, criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, and the ability to significantly influence operations and accountability for fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the City is able to exercise oversight responsibilities. Based upon the application of these criteria, no potential component units were identified for inclusion in the reporting entity.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City have been prepared in conformity with GAAP as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the government's accounting policies are described below.

A. Basis of Presentation

The City's basic financial statements consist of government-wide statements, including a statement of net assets and a statement of activities, and fund financial statements which provide a more detailed level of financial information.

Government-wide Financial Statements The statement of net assets and the statement of activities display information about the City as a whole. These statements include the financial activities of the primary government. The statements distinguish between those activities of the City that are governmental (primarily supported by taxes, County appropriations and intergovernmental revenues) and those that are considered business-type activities (primarily supported by fees and charges).

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES – Continued

The statement of net assets presents the financial condition of the governmental and business-type activities of the City at year-end. The statement of activities presents a comparison between direct expenses and program revenues for each program or function of the City's governmental activities and for the business-type activities of the City. Direct expenses are those that are specifically associated with a service, program or department and therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient of the goods or services offered by the program, grants and contributions that are restricted to meeting the operational or capital requirements of a particular program and interest earned on grants that is required to be used to support a particular program. Revenues which are not classified as program revenues are presented as general revenues of the City. The comparison of direct expenses with program revenues identifies the extent to which each business segment or governmental function is self-financing or draws from the general revenues of the City.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements.

Fund Financial Statements During the year, the City segregates transactions related to certain City functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at this more detailed level. The focus of governmental and enterprise fund financial statements is on major funds. Each enterprise and governmental fund was a major fund and is presented in a separate column.

B. Fund Accounting

The accounts of the City are organized on the basis of funds and account groups, each of which is considered to be a separate accounting entity. The operations of each fund are summarized by providing a separate set of self-balancing accounts which include its assets, liabilities, fund equity, revenues and expenses or expenditures. The following funds and account groups are used by the City:

Governmental Fund Types

General Fund

The General Fund is the general operating fund of the City. All financial resources, except those required to be accounted for in another fund, are accounted for in this fund.

Special Revenue Funds

The Community Block Grant Fund is a special revenue fund used to account for the revenue from Community Development Block Grants received by the City of Frostburg. In the event an expenditure is incurred for purposes for which both restricted and unrestricted net assets are available, restricted resources are used first.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES – Continued

Proprietary Fund Type

Water, Sewer, Water Surcharge, and Garbage Funds

The Water, Sewer, Water Surcharge, and Garbage Funds are enterprise funds used to account for the operations which are financed and operated in a manner similar to private businesses. The intent is that the cost of providing the services to the public is to be financed or recovered primarily through user charges.

C. Measurement Focus

Government-wide Financial Statements The government-wide financial statements are prepared using the economic resources measurement focus. All assets and all liabilities associated with the operation of the City are included on the statement of net assets. The statement of activities presents increases (i.e. revenues) and decreases (i.e. expenses) in total net assets.

Fund Financial Statements All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures and changes in fund balances reports on the sources (e.g., revenues and other financing sources) and uses (e.g., expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements therefore include reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

Like the government-wide statements, the enterprise fund is accounted for on a flow of economic resources measurement focus. All assets and all liabilities associated with the operation of this fund are included on the statement of net assets. The statement of changes in fund net assets presents increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The statement of cash flows provides information about how the City finances and meets the cash flow needs of its enterprise funds.

D. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary funds also use the accrual basis of accounting. Differences in the accrual and modified accrual bases of accounting arise in the recognition of revenue, the recording of deferred revenue and in the presentation of expenses versus expenditures.

The modified accrual basis of accounting is used by all governmental fund types. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES – Continued

current period or soon enough thereafter to be used to pay liabilities of the current period. The City considers property taxes as available if they are collected within 60 days after year-end. Penalties and interest and miscellaneous revenues are recorded when received in cash since they are generally not measurable until actually collected. Expenditures are recorded when the related fund liability is incurred.

The proprietary funds are accounted for on a flow of economic resources measurement focus. The accrual basis of accounting is utilized by the proprietary fund types. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. All GASB pronouncements are followed in the proprietary funds. FASB, APB Opinions and ARB's issued before November 30, 1989 are followed to the extent they do not contradict GASB. FASB pronouncements issued after November 30, 1989 that are developed for business entities are followed to the extent that they do not contradict GASB.

The City reports deferred revenue on its combined balance sheet. Deferred revenues arise when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received by the City before it has a legal claim to them, as when grant monies are received prior to the incurring of qualifying expenditures. In subsequent periods, where both revenue recognition criteria are met or when the City has a legal claim to the resources, the liability for deferred revenue is removed from the combined balance sheet and revenue is recognized.

E. Budgets and Budgetary Accounting

Formal budgetary accounting, as set forth in the City Charter, is employed as a management control for the General Fund and the Water, Sewer, Water Surcharge, and Garbage Enterprise Funds. Annual operating budgets are adopted by the City each fiscal year through passage of an annual budget and amended as required for all funds. Budget amendments requiring a change between categories requires approval by the Mayor and City Council. A budget reconciliation has been provided to reflect the differences between budgetary inflows and outflows and GAAP revenues and expenses/expenditures. Budgets presented in the financial statements reflect all amendments.

The budget for the Enterprise Funds is adopted under the GAAP basis of accounting except that depreciation is not considered. The City does not budget for the Special Revenue Fund since budgetary control is maintained on an individual grant basis.

F. Post Employment Health Care Benefits

The City continues group health care coverage for employees who retire at age 60 until they are eligible for Medicare benefits. During the fiscal year ended June 30, 2006, there were two retired employees receiving benefits. The cost of retiree health care is recognized as expenditures as the premiums are paid. For the fiscal year ended June 30, 2006, there were premiums paid in the amount of \$13,471. The average age of the City employees is approximately 45 years old and three employees are over age 60 and are eligible for these benefits. These employees have no immediate plans to retire. The City currently feels that this potential liability is immaterial.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES -- Continued

G. Cash and Equivalents

For financial statement purposes, the City considers all short-term, highly liquid investments with an original maturity of three months or less to be cash and cash equivalents

H. Capital Assets

General capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the enterprise funds are reported both in the business-type activities column of the government-wide statement of net assets and in the funds.

All capital assets are capitalized at cost (or estimated historical cost). When a capital asset is disposed or retired, the cost and related accumulated depreciation is removed from the books with any gain or loss reflected as income. The City maintains a capitalization threshold of \$5,000. Public domain ("infrastructure") general fixed assets including roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems are capitalized along with other general fixed assets. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not.

All reported capital assets except land are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives.

Land improvements	10-20 years
Building and improvements	25-40 years
Machinery and equipment	5-10 years
Infrastructure and utility systems	20-40 years

In the Water Fund, depreciation is recorded at a rate of 2.2% of the current year acquisitions and 3.33% of the prior years fixed asset balance. Depreciation was recorded at the rate of 2.5% of the EDA water improvements and the Piney Dam construction projects.

I. Capitalized Interest

Interest costs incurred by proprietary funds on debt where the proceeds were used to finance the construction of assets are capitalized.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES – Continued

J. Compensated Absences

The City has implemented the provisions of the Governmental Accounting Standards Board's Statement No. 16, Accounting for Compensated Absences. This statement requires the recording of accumulated unused sick leave and comp time if such amounts will be paid as termination benefits. The comp time liability is calculated by taking the total hours of comp time outstanding at June 30, times the average rate of pay by department. One paid sick day is accrued for each month of service after the probationary period up to a maximum of 150 days. Upon termination of employment, the accumulated sick leave is lost. Upon reaching the age of 60 and retirement, the employee is paid for 20% of the accumulated sick leave at the employee's current rate of pay.

At June 30, 2006, no liability has been recorded for the current portion of compensated absences as the City feels that absences used during the next year will not materially exceed the absences earned during the next year. Therefore, all compensated absences are recorded as long-term. The long-term portion of this liability of \$92,324 has been recorded in the government-wide statement of net assets, of which \$21,053 is from business-type activities. This represents an increase of \$565 over the prior year total of \$91,759, of which \$16,581 was from the business-type activities.

K. Interfund Activity

Transfers between governmental and business-type activities on the government-wide statements are reported in the same manner as general revenues.

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds and after nonoperating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the financial statements.

Interfund transfers for the year ended June 30, 2006 consisted of transfers of \$92,000 from both the Water and Sewer Funds to the General Fund and \$13,000 from the Garbage Fund to the General Fund to help cover administrative overhead costs. In addition, the Mayor and City Council voted to transfer 25% of the proceeds from certain timber sales from the Water Fund to the General Fund to be used for normal operations. This amount totaled \$84,440 for the year ended June 30, 2006.

L. Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables." These amounts are eliminated in the governmental and business-type activities columns of the statement of net assets, except for the net residual amounts due between governmental and business-type activities, which are presented as internal balances. Interfund balances have no set repayment schedule and are generally not expected to be repaid within one year.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES -- Continued

L. Interfund Balances - Continued

The composition of interfund balances as of June 30, 2006 is as follows:

Receivable Fund	Payable Fund	Amount
General	Water Fund	\$ 421,688
General	Sewer Fund	140,607
General	Garbage	13,005
Special Revenue	Sewer Fund	20
		<u>\$ 575,320</u>

M. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the City, these revenues are for services primarily provided by the Water, Water Surcharge, Sewer, and Garbage Funds to the general public. Operating expenses are necessary costs incurred to provide the service that is the primary activity of the fund. Revenues and expenses not meeting this definition are reported as non-operating.

N. Property Taxes

Taxes are levied each July 1 on the assessed value listed as of the prior January 1 for all real property located within City boundaries which receive substantially all City services and payable without penalty until September 30. The City bills and collects its own property taxes. City property tax revenues are recognized when levied to the extent that they result in current receivables. Assessed values are established by the Maryland Department of Assessments and Taxation based on estimates of fair market value. A revaluation of all property is required to be completed every three years and any increase in assessed value is phased in over a three year period. For the year ended June 30, 2006, the City had a tax margin of \$.55 per \$100 assessed valuation.

O. Credit Risk

As of June 30, 2006, the City has recorded receivables from various entities and individuals. As these receivables are believed to be completely collectable, an allowance for doubtful accounts is not recorded. If an account is determined to be uncollectible, the direct write-off method is used. This does not produce a result materially different from the allowance method of accounting.

P. Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 3 CASH AND INVESTMENTS

The cash deposits of the City of Frostburg are governed by Maryland Article 95-22. The City may establish official depositories with any bank or savings and loan located in the state of Maryland. The City may also establish time deposits and certificates of deposit. As of June 30, 2006, the reconciled balances of the City's deposits were \$1,374,735 and the bank balances were \$1,871,791. Of the bank balances, \$284,906 was covered by federal depository insurance and \$1,586,885 was covered by collateral held by the financial institutions in the City's name.

The investment policy of the City is to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the city and conforming to all state and local statutes governing the investment of public funds. The primary objectives, in priority order, of the City's investment activities shall be safety, liquidity, and return on investment.

At June 30, 2006, the City had a certificate of deposit in the amount of \$84,403 held at a local financial institution which is included in the City's deposit figure of \$1,374,735. The certificate of deposit is set to mature in March 2007.

The City's deposits are categorized to give an indication of the level of risk assumed by the City at year-end. Category 1 includes deposits that are insured or collateralized with securities held by the City or its agent in the City's name. Category 2 includes uninsured but collateralized deposits for which the securities are held by the counterparty's trust department or agent in the City's name. Category 3 includes uncollateralized (and uninsured) deposits and collateralized deposits for which the securities are held by the counterparty or by its trust department or agent but not in the City's name. At June 30, 2006, \$284,906 of deposits are category 1 deposits and the remaining \$1,586,885 are category 2 deposits.

NOTE 4 ACCOUNTS RECEIVABLE

The City's accounts receivable as of June 30, 2006 consisted of the following:

	Governmental	Water	Sewer	Water Surcharge	Garbage	Total
Taxes	\$ 109,848	\$ -	\$ -	\$ -	\$ -	\$ 109,848
Intergovernmental	231,222	-	230,860	-	-	462,082
Charge for services	-	169,280	248,966	144,346	100,802	663,394
Interest	-	276	719	2,254	1,757	5,006
Other	39,212	2,330	33,254	-	-	74,796
Total	\$ 380,282	\$ 171,886	\$ 513,799	\$ 146,600	\$ 102,559	\$ 1,315,126

At the end of the current fiscal year, deferred revenue of \$76,109 was recognized due to unavailability in the governmental fund statements.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 5 CAPITAL ASSETS

The following is a summary of the changes in the fixed asset accounts for the year ended June 30, 2006:

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Governmental Activities					
Non-depreciable Assets					
Land	\$ 1,947,049	\$ -	\$ -	\$ -	\$ 1,947,049
Construction-in-progress	271,161	342,931	-	(612,442)	1,650
Total Non-depreciable Assets	2,218,210	342,931	-	(612,442)	1,948,699
Depreciable Assets					
Land Improvements	551,155	-	-	372,890	924,045
Buildings and Improvements	2,967,279	23,629	-	239,552	3,230,460
Infrastructure	4,722,595	115,418	-	-	4,838,013
Machinery & equipment	1,200,717	103,936	-	(180,278)	1,124,375
Total Depreciable Assets	9,441,746	242,983	-	432,164	10,116,893
Less, Accumulated Depreciation for:					
Land Improvements	161,007	38,079	-	-	199,086
Buildings and Improvements	1,144,022	103,265	-	-	1,247,287
Infrastructure	821,483	108,855	-	-	930,338
Machinery & equipment	832,283	49,639	-	(162,250)	719,672
Total Accumulated Depreciation	2,958,795	299,838	-	(162,250)	3,096,383
Depreciable Assets, net of accumulated depreciation	6,482,951	(56,855)	-	594,414	7,020,510
Total Governmental Capital Assets, net of accumulated depreciation	\$ 8,701,161	\$ 286,076	\$ -	\$ (18,028)	\$ 8,969,209
Business-type Activities					
Non-depreciable Assets					
Land	\$ 48,299	\$ -	\$ -	\$ -	\$ 48,299
Construction-in-progress	757,650	2,403,346	-	(3,113,748)	47,248
Total Non-depreciable Assets	805,949	2,403,346	-	(3,113,748)	95,547
Depreciable Assets					
Land Improvements	12,908,917	-	-	-	12,908,917
Buildings and Improvements	8,291,261	-	-	-	8,291,261
Infrastructure	5,506,347	-	-	3,113,748	8,620,095
Machinery & equipment	727,344	72,392	-	180,278	980,014
Total Depreciable Assets	27,433,869	72,392	-	3,294,026	30,800,287
Less, Accumulated Depreciation for:					
Land Improvements	4,439,652	330,363	-	-	4,770,015
Buildings and Improvements	2,275,226	275,935	-	-	2,551,161
Infrastructure	1,295,670	188,794	-	-	1,484,464
Machinery & equipment	287,612	44,177	-	162,250	494,039
Total Accumulated Depreciation	8,298,160	839,269	-	162,250	9,299,679
Depreciable Assets, net of accumulated depreciation	19,135,709	(766,877)	-	3,131,776	21,500,608
Total Business-type Capital Assets, net of accumulated depreciation	\$ 19,941,658	\$ 1,636,469	\$ -	\$ 18,028	\$ 21,596,155

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 5 CAPITAL ASSETS - Continued

Depreciation expense for governmental capital assets was charged to the following accounts as follows for the year ended June 30, 2006:

General Government	\$ 63,258
Public Safety	23,876
Public Works	154,675
Recreation and Parks	58,029
Total	<u>\$ 299,838</u>

NOTE 6 LONG-TERM DEBT

The following is a summary of the changes in long-term debt for the year ended June 30, 2006:

	Outstanding 6/30/2005	Additions	Reductions	Outstanding 6/30/2006	Due Within One Year
Governmental Activities					
Bonds & Notes Payable					
M & T Bank - Armory Restoration	\$ 97,966	\$ -	\$ (46,273)	\$ 51,693	\$ 51,693
Fidelity Bank - Rec Complex/Street Lighting	319,000	-	(44,000)	275,000	44,000
GMAC Capital Lease	43,516	-	(12,281)	31,235	12,929
Subtotal	460,482	-	(102,554)	357,928	108,622
Other Obligations					
Compensated Absences	75,178	-	(3,907)	71,271	-
Total Governmental Activity Long-term Obligations	<u>\$ 535,660</u>	<u>\$ -</u>	<u>\$ (106,461)</u>	<u>\$ 429,199</u>	<u>\$ 108,622</u>
Business-type Activities					
Bonds & Notes Payable					
CDA - Piney Dam Project	\$ 5,455,000	\$ -	\$ (135,000)	\$ 5,320,000	\$ 140,000
Allegany County - Sewer Liability	57,425	-	(28,690)	28,735	28,735
MDE - Emergency Sewer Project	237,975	-	(13,271)	224,704	13,540
CDA - Various Projects	4,758,900	-	(199,400)	4,559,500	203,400
Subtotal	10,509,300	-	(376,361)	10,132,939	385,675
Other Obligations					
Compensated Absences	16,581	4,472	-	21,053	-
Total Business-type Activity Long-term Obligations	<u>\$ 10,525,881</u>	<u>\$ 4,472</u>	<u>\$ (376,361)</u>	<u>\$ 10,153,992</u>	<u>\$ 385,675</u>

The CDA -Various Projects bond was issued in 2003 and partially drawn on in 2003, 2004 and 2005. The final draw in the amount of \$953,556 occurred during 2006. The bond was used as follows:

	Total
Refinance of the following:	
FHA - Piney Dam Reservoir	\$ 203,049
FHA - Filtration Plant	2,383,125
CDA - Centennial Hill	379,665
Refinancing Fees	81,524
Route 40 Project	242,850
Centennial Hill	594,135
Dome Covers	1,263,352
	<u>\$5,147,700</u>

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 LONG-TERM DEBT - Continued

The loan payable to M & T Bank for the Armory restoration is payable in monthly installments of \$4,211 with an interest rate of 5.39%. The loan is uncollateralized and has 12 monthly payments remaining.

The loan payable to Fidelity Bank was used for the Main Street Lighting and Recreation Complex projects and is payable in monthly installments of \$3,667 plus interest at 4.45%. The loan is uncollateralized and has 75 monthly installments remaining.

The capital lease payable to General Motors Acceptance Corporation is payable in 48 monthly installments of \$1,186 with an interest rate of 5.15%. The lease is collateralized with two vehicles and has 28 monthly installments remaining. The original cost of the two vehicles totaled \$51,580 with a current book value of \$37,654.

The CDA bond payable for the Piney Dam Project is payable in variable annual installments of principal plus semi-annual installments for interest and issuance costs. Interest rates range from 4.15% to 5.20% and the issuance fees range from \$1,217 to 1,444 per installment. The bond is insured and has 22 installments of principal, interest, and issuance costs and an additional 22 installments of interest and issuance costs only remaining.

The loan payable to Allegany County is a result of a settlement that was drafted for the City of Frostburg's share of wastewater treatment costs by the City of Cumberland's sewage treatment plant. Payments began in August 1992 and are being made annually over a fifteen year period set to expire in August 2007. The loan requires annual installments of \$28,735 plus interest at 6.1% and has 1 remaining installment.

The bond payable to the Maryland Department of Environment is payable in variable annual installments of principal and issuance fees plus semi-annual installments for interest at 2.50%. The issuance fees paid annually are fixed in the amount of \$979. The bond has 14 installments of principal, interest, and issuance costs and an additional 14 installments of interest only remaining.

The CDA bond payable for various projects is payable in variable annual installments of principal plus semi-annual installments for interest and issuance costs. Interest rates range from 2.00% to 4.50% and the issuance fees range from \$707 to \$806 per installment. The bond is insured and has 17 installments of principal, interest, and issuance costs and an additional 17 installments of interest and issuance costs only remaining.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6 LONG-TERM DEBT – Continued

The annual requirements to amortize all general long-term debt, as of June 30, 2006, are as follows:

Fiscal Year	Governmental Activities		Business-type Activities		Total		
	Principal	Interest & Fees	Principal	Interest & Fees	Principal	Interest & Fees	Total
2007	\$ 108,622	\$ 13,271	\$ 385,675	\$ 452,764	\$ 494,297	\$ 466,035	\$ 960,332
2008	57,611	10,006	368,392	439,813	426,003	449,819	875,822
2009	48,695	7,474	377,753	427,439	426,448	434,913	861,361
2010	44,000	5,466	396,124	413,761	440,124	419,227	859,351
2011	44,000	3,508	407,604	399,217	451,604	402,725	854,329
2012-2016	55,000	1,631	2,311,678	1,737,255	2,366,678	1,738,886	4,105,564
2017-2021	-	-	2,832,913	1,190,414	2,832,913	1,190,414	4,023,327
2022-2026	-	-	2,292,800	518,888	2,292,800	518,888	2,811,688
2027-2031	-	-	760,000	65,576	760,000	65,576	825,576
	<u>\$ 357,928</u>	<u>\$ 41,356</u>	<u>\$ 10,132,939</u>	<u>\$ 5,645,127</u>	<u>\$ 10,490,867</u>	<u>\$ 5,686,483</u>	<u>\$ 16,177,350</u>

The source of funds for debt retirement is as follows:

	Debt Amount
General revenue	\$ 357,928
Sewer charges	253,439
Water surcharges	9,879,500
	<u>\$ 10,490,867</u>

All compensated absences in the governmental activities will be paid out of the general fund. All compensated absences in the proprietary funds will be paid out of the funds where the liability was incurred.

NOTE 7 RESTRICTED ASSETS – WATER SURCHARGE FUND

The Water Surcharge Fund is a restricted fund to be used for the improvements, construction, debt service, and other capital projects of the Piney Dam and the Water Treatment Plant. Fund income is derived from a surcharge to water service customers.

NOTE 8 DESIGNATED UNRESTRICTED NET ASSETS – WATER FUND

The City received \$339,706 from the sale of timber during the year. Of this amount the Mayor and City Council transferred \$84,440 to the General Fund to be used for normal operations. Of the remaining balance, \$168,880 has been designated to be used for watershed improvements and water quality.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9 PENSION PLAN

On December 6, 1982 the City adopted a money purchase pension plan that covers substantially all of its employees. All contributions, through ICMA, are invested with the consent of the pension committee. Employees may make voluntary contributions up to 10% of their annual compensation. The City contributes 9% of total compensation for all employees who have at least one year of service, are twenty-one years of age, have at least 1,000 hours of service, and are not members of a union. Employees become fully vested after 5 years of service. For the year ended June 30, 2006, the cost of this plan was \$110,215. Contributions will not be made to this plan in future years.

Effective July 1, 2006 the City entered into Maryland's State Retirement and Pension System (SRPS), a cost sharing multiple-employer defined benefit pension plan administered by the State of Maryland. SRPS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Article 73B of the Annotated Code of the State of Maryland assigns the authority to establish and amend benefit provisions to the SRPS Board of Trustees. Employees will receive credit under the new system retroactively dated based on when they became employed by the City. Under the agreement, the City will be required to purchase 50% of the back service at a cost not expected to exceed \$1,629,590. The cost will be financed at a fixed rate of interest over 25 years and is expected to be approximately \$143,938 per year in addition to the City's regular pension contribution which is expected to be approximately \$113,000 per year. The actual cost of the buy-in will be determined by actuarial values based on individuals employed by the City as of July 1, 2006. The actual cost and method of financing has not been determined as of the date of the audit.

NOTE 10 COMMUNITY DEVELOPMENT BLOCK GRANT FUND – INDIRECT COSTS

The City does not charge indirect costs against Community Development Block Grant Funds, and accordingly, no Statement of Indirect Costs has been prepared.

NOTE 11 SCENIC RAILROAD CONSTRUCTION – GENERAL FUND

The City continues to contribute to the promotion of the Scenic Railroad. The City contributed \$25,000 to the Scenic Railroad during the year ended June 30, 2006.

NOTE 12 OPERATING LEASE

The City leases the Armory building to the State of Maryland. The City renewed the lease effective November 1, 2002 through 2007 with a monthly lease payment of \$6,513. The minimum lease payment for this five year period is expected to be \$78,156 per year.

On December 30, 2003 the City entered into an operating lease with Queen City Business Systems for a copy machine. The lease requires 60 monthly payments of \$221 per month and is set to expire on December 30, 2008.

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 12 OPERATING LEASE – Continued

On March 5, 2004, the City entered into an operating lease with Pitney Bowes for a postage machine. The lease requires 54 monthly payments of \$455 per month and is set to expire September 5, 2008.

Future minimum lease payments are expected to be as follows:

2007	\$ 8,112
2008	8,112
2009	<u>2,691</u>
Total	<u>\$ 18,915</u>

Rental income for the Armory building totaled \$78,150 for the year ended June 30, 2006. Rent expense for the copy machine and postage machine totaled \$8,112 for the year ended June 30, 2006.

NOTE 13 INSURANCE RECOVERIES

The City received \$7,694 of insurance recoveries for the year as a result of various accidents involving City property. This amount is included in miscellaneous revenues on the government-wide statements and as other income on the governmental fund financial statements.

NOTE 14 RISK OF LOSS

The City utilizes commercial insurance for employee life, health, disability, and workers' compensation as well as its property and liability insurance. The City retains the risk of loss for Maryland Unemployment Compensation. The City feels that the commercial insurance provides adequate coverage and that the potential loss from Maryland Unemployment Compensation is immaterial to the City's overall financial position.

NOTE 15 EQUITY TRANSFER FROM GENERAL FUND TO GARBAGE FUND

On July 1, 2005, the City set up an additional proprietary fund to be used to account for garbage collections. The assets and liabilities directly related to the new fund were transferred from the General Fund to the Garbage Fund. The reconciliation of the amount of equity transferred shown on the government-wide statements versus the funds statements is as follows:

Fund Balance - Governmental Funds	\$ 75,703
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.	
Governmental capital assets, net of accumulated depreciation	18,028
Long-term liabilities are not due and payable in the current period, and therefore are not reported as liabilities in the funds.	
Compensated absences	(1,199)
Total Net Assets - Governmental Activities	<u>\$ 92,532</u>

CITY OF FROSTBURG, MARYLAND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 16 CONTINGENCIES

On June 13, 2005, Allegany County petitioned the Maryland Public Service Commission to exercise its jurisdiction to set inter-jurisdictional water rates pursuant to §4-305 of the Public Utility Companies Article ("PUC Article") for water supplied by the City of Frostburg within the City and to the County.

The City proposed new water rates to the County for city residents and those residents outside of the city limits based on the results of the study done by the Public Service Commission. The proposed rates were rejected by the County. The City is continuing to work with the Public Service Commission and the County to determine the new water rates.

NOTE 17 COMMITMENTS

As of June 30, 2006, the City began work on the N. Water Street and Broadway Street Combined Sewer Overflow projects with the purpose of separating combined sanitary and storm sewer lines and to improve storm drains. The total cost of these projects is estimated to be \$3,000,000 dollars, of which \$1,000,000 will be funded with Bay Restoration funds, \$800,000 will be funded with Community Development Block Grant funds, \$700,000 will be funded by Water Quality funds, \$400,000 will be funded with Access Road funds, and the remainder will be funded by the City.

NOTE 18 NEW PRONOUNCEMENTS

The Governmental Accounting Standards Board has issued statement #45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions," (GASB 45) which is effective for the City's June 30, 2010 year end. GASB 45 requires postemployment benefits to be accounted for as the benefits are earned rather than when they are paid. Under the new standard, the City will be required to record an actuarially determined liability while the employees are working rather than recording expenditures when the benefits are paid. The City plans to implement the new standard by the June 30, 2010 year end.

CITY OF FROSTBURG, MARYLAND

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2006**

	Unrestricted			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Budgetary Basis	Final Budget Positive (Negative)
REVENUES				
Taxes				
Net property tax revenue	\$ 1,370,000	\$ 1,425,500	\$ 1,457,557	\$ 32,057
Income taxes	380,000	380,000	387,475	7,475
Hotel motel tax	120,000	140,000	154,690	14,690
Highway use tax	375,000	500,000	563,547	63,547
Other taxes	104,900	113,400	118,742	5,342
Police protection grant	140,000	140,000	138,489	(1,511)
Public safety revenue	87,000	72,000	71,069	(931)
Licenses and permits	31,000	46,000	52,572	6,572
COPS grants	40,000	30,000	31,185	1,185
Rental program revenue	65,000	55,400	58,125	2,725
Recreational activities	29,000	36,000	41,146	5,146
Grant income - other	257,000	250,676	244,163	(6,513)
Transfers from other funds	197,000	197,000	281,440	84,440
Other income	100,950	97,950	103,681	5,731
Interest	7,000	10,000	12,971	2,971
TOTAL GENERAL FUND REVENUE	3,303,850	3,493,926	3,716,852	222,926
EXPENDITURES				
Administration	742,448	875,748	880,081	(4,333)
Public safety	1,243,083	1,179,313	1,123,543	55,770
Street department	656,430	778,252	819,606	(41,354)
Recreation department	661,889	660,613	675,968	(15,355)
TOTAL EXPENDITURES	3,303,850	3,493,926	3,499,198	(5,272)
EXCESS OF RESOURCES OVER CHARGES TO APPROPRIATIONS	\$ -	\$ -	\$ 217,654	\$ 217,654

Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

Sources/inflows of resources

Actual budgetary basis "general fund revenue" from the budgetary comparison schedule	\$ 3,716,852
Differences - budget to GAAP:	
Transfers from other funds are inflows of budgetary resources but are not revenues for financial reporting purposes	(281,440)
Rental income is income from budgetary resources but are not revenues for financial reporting purposes	(78,150)
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balance - governmental funds	\$ 3,357,262

The accompanying notes are an integral part of these financial statements.